Stevens, Frank Walker

The valuation of railroad right of way

[S.l.]

1914

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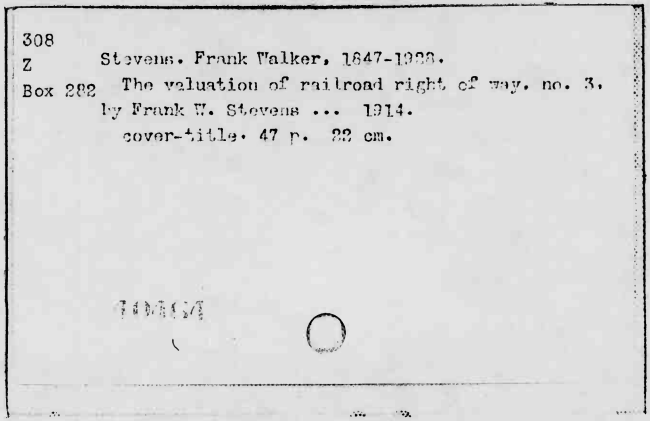
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THE VALUATION OF RAILROAD RIGHT OF WAY

No. 3

BY

FRANK W. STEVENS

Counsel for New York Central Lines

1914

June 25, 1930 DA/ree

The Valuation of Railroad Right of Way

No. 3

Any method of valuing right of way which disregards that element of value arising from the extent of the demand for its use, past, present and prospective, is confiscatory, and the sole function of courts in rate making cases is to prevent confiscation.

There is a very active class of persons who entertain the view that in rate making the basis upon which returns should be allowed is the cash investment actually made in the construction and creation of the property used in the public service. This view was explicitly stated by Commissioner Clements of the Interstate Commerce Commission in his statement before the Committee on Interstate and Foreign Commerce of the House of Representatives on February 15th, 1912, the Committee then being engaged in considering the bill which with modifications and amendments finally became the present Valuation Act, Section 19-a of the Act to Regulate Commerce. At page 209 of the report of the hearings before the Senate and House of Representatives, he says:

> "Now, speaking for myself, I think it is sound justice and law that *as a basis for constitutional earnings* a fair return on the value of the property means, generally speaking, a fair return on the *investment actually made*, originally and subsequently."

This thought was in the mind of Commissioner Meyer in making his statement before the same Committee on the 16th day of February, 1912, although he does not commit himself personally to it. On page 230 of the same report the Commissioner says:

> "But there is an element, and one that if the Interstate Commerce Commission is to make this investigation you gentlemen will have to give us some instruc-

tions upon, I think, namely, how to treat property that was originally donated, and what to do with the advance in the value of railway property due to the development of the community. That is directly involved in the question of physical valuation."

Professor John R. Commons, of Wisconsin, who, I think it may be fairly said, was the principal witness before the Senate Committee on Interstate Commerce during the hearings upon the valuation bill, made an elaborate argument touching the principles which should govern the relations of railroads to the public and especially concerning the basis of the returns to which railroads are entitled. At page 100 of the report he says:

> "In other words, the amount of value on which the company is entitled to earn a profit is the amount of its real or reasonable investment—the amount which the owners have taken out of their own pockets, which they might have invested elsewhere under fair competitive conditions and secured thus a fair competitive return. But if the public has paid a higher rate, and that higher rate has gone into the new construction of physical property, that excess of the inventory value of the physical property does not represent a credit on the side of the company against the public, but represents a contribution which the public has made toward the physical property."

The Interstate Commerce Commission in its opinion in the Advances in Rates Cases, Western Case (20 I. C. C. Rep., 307) speaking of the same matter, on page 347, says:

> "Perhaps the nearest approximation to the fair standard (for a basis upon which to compute the return) *is that of bona fide investment*—the sacrifice made by the owners of the property—considering as part of the investment any shortage of return that there may be in the early years of the enterprise. Upon this, taking the life history of the road through a number of years, its promoters are entitled to a reasonable return. This, however, manifestly is limited; for a return should not be given upon wastefulness, mismanagement, or poor judgment, and always there is present the restriction that no more than a reasonable rate shall be charged."

So on page 334 of the same case it is said:

> "It would appear that one of the problems of the future

> in railroad regulation is to discover the machinery by which the railroad may justly take to itself *an adequate return for the investment which its stockholders have made* and share with the community the advantages of the surplus which it creates."

So in discussing the case of the Burlington road in the same opinion at page 337 the Commission says:

> "When asked by the Government to explain why it has increased its charges, its reply is that it has a right to do so because it is not now receiving a fair return upon the value of the property which it uses; value being estimated cost of reproduction. This leads to a few questions: (1) What did the Burlington road cost those who built it? (2) What is its present value? (3) Whence came this value? (4) Is such increase in value a basis for increase in rates?"

The discussion which follows these queries, extending as it does over several pages, is too long to quote, but it is an interesting example of the views which are put forward upon this subject.

So in the Eastern Case at page 269 of the same volume of reports may be found the following:

> "The President of the Pennsylvania Company testified that since 1887 his company had put into the Pennsylvania Lines east of Pittsburgh $262,000,000 from earnings. During all that time this company has also paid to its stockholders munificent dividends. Now, to whom belongs this $262,000,000, a sum which, according to the statistical report of the Pennsylvania Railroad Company to this Commission for the year ending June 30, 1910, equals nearly two-thirds of the total cost of construction of the 2,123 miles owned by that company?
>
> "Suppose this Commission were required to fix a value upon the Pennsylvania Lines east of Pittsburgh. Could any distinction be made between this sum which has accrued from the operation of the property and what has been paid in from other sources?
>
> "We are not required at this time to express an opinion upon that point."

It is unnecessary to multiply quotations showing what persons or officials hold to the view that the return in rate making cases should be based upon the actual investment and

that no allowance should be made for appreciation of property or for property donated to the company or for franchises. The quotations already made are sufficient to show that the point is one of very great importance and can not be ignored in any discussion of railroad valuation.

How the Supporters of the investment basis construe the ruling of the Supreme Court that the proper basis is the value of the property used in the public service.

The Supreme Court in the case of Smyth v. Ames, 169 U. S. 466, used the following language:

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction, must be the fair value of the property to be used by it for the convenience of the public."

If value be what I have maintained it to be in preceding pamphlets, this utterance of the Supreme Court manifestly disposes completely of the view that the amount of the investment is the proper basis unless, perchance, it should happen that the investment and the value coincide in amount, which, of course, would be a matter of chance and not of principle. It is important, therefore, to note how the supporters of the investment theory construe the decisions of the Supreme Court affirming value to be the thing to be protected in rate making. The method adopted by them is very simple. In order that it may be stated in their own language, I quote from the statement of Professor Commons before the Senate Committee on the 13th day of February, 1914, the quotation being found on page 84. He said:

> "The Supreme Court of the United States has really been working out a theory of value in the past 40 years, since the Munn case, and has very materially recast its old conception or idea of what value consisted in.
>
> *"The fundamental basis of the court's opinion is not market value or competitive value or actual value, but it is that of a fair or reasonable or just value.* The court has recast its theory of value in rate making cases because it has perceived that in setting up a value for the property it has created substantially a creditor and

> debtor relationship; that the owners of the property are in the nature of creditors and the public is in the nature of debtors for something that has been devoted to their service."

So again on page 86, after a somewhat elaborate elucidation of what the court's view of value was prior to the decision in the Munn case, he further proceeds:

> "But the court even then did not enter into the question of value or valuation, it not being necessary to the decision in that case, and we may say that from that time, 1889, down to the present time—the latest cases being the Consolidated Gas case in New York and the Knoxville Water case, which were decided within the last two years, and possibly one or two more recent cases—during that period the court has been making a transition. *It has been shifting its ground as to what is the value, or valuation, or the amount of value for rate-fixing purposes in these various cases that have arisen.*"

Again upon page 87, after further elucidation of his views, he says:

> "Now, during this period, following the ad valorem tax cases (the Express Co. cases from Ohio) down to the present, or down to the last four or five years—you might say down to the time of the Stanislaus case, decided in 1902, which came up from California—the court was very undecided as to what were the elements of value which should be taken into account."

After a further lengthy review of the principles upon which he relies, he says at page 100:

> "Now, I do not know that any cases have come to the courts involving these questions, either in taxation or in rate fixing, *and that is the very reason why this bill should provide for this original cost to date in order that the court may have before it the actual facts and the amount of differences involved in these different methods of valuation.*"

Again at page 101 he says:

> "Now, the securing of those two items would make it possible for the court to consider this question, whether a railroad corporation is entitled to an appreciation in its land values equivalent to the appreciation which private owners adjoining have enjoyed in the appreciation of their land values."

In speaking of those whom the Commission should bring to its aid in making the valuation of railroad properties, he says at page 102:

> "The engineer is essential in making this valuation. It can not be made without his assistance, but all that he can make is a physical inventory. As engineer it is not his province to go into the constitutional question of reasonable value. For that purpose the valuing board would need a constitutional lawyer, a person familiar with the decisions of the courts *and the principles of reasonable valuation as against market valuation.* The engineer's idea of values is usually confused. He does not distinguish between what you might call the engineering use, or engineering value of the property, and its valuation as a charge against the public."

Further on, page 102, he says:

> "Now, to correct the engineer in that computation it is necessary to have an accountant. An accountant is just as essential to this valuation as an engineer, *and the engineer's value should be made under the direction of others who have the idea which is involved in this case of reasonable value.* I should say also that there should be needed an economist, because the court is really acting as a kind of faculty of political economy. They are working out a theory of value which economists are also working out; the two theories do not always gibe. But there ought to be somebody there who knows the literature and the theories of value, so that he can properly weigh the different theories and properly distinguish between them, and also between this reasonable value, which economists do not usually take into account, and these market values which are the dominant ideas in the minds of economists."

His own views on the effect of the court's decisions are explicitly stated on page 107:

> "My own idea is that if the case were properly presented to the court the court would adhere to the idea of reasonableness throughout, and would recognize that, for rate-fixing purposes this property, being devoted to a public use, *was entitled only to a return on the actual reasonable investment cost of the property.*"

The foregoing extracts from Professor Commons' statement are somewhat lengthy, but they are all needed in order

to present a fair view of the position taken by him, namely, that the returns to a railroad corporation should be based upon the amount of actual investment and that no returns should be allowed upon appreciated values, upon donations, or upon franchises given by the public, and that such is the proper result of the decisions of the Supreme Court.

Summary of what is involved in the foregoing views.

I think the following is a fair summary of the position taken by those who hold for the investment theory as above set forth:

(1) The valuation now being carried on is to be used for rate making purposes.

(2) That in rate making the basis of calculation is the "fair" or "reasonable" value of the property employed in the public service, which "reasonable value" is nothing more or less than the actual, reasonable investment cost of the property.

(3) That "fair" or "reasonable" value is not value in the ordinary or economic sense of value, it is not market value or exchange value, or as I have seen it recently stated: "As the law now stands there is no such thing as 'value' of railroad property, using value in the sense in which it is ordinarily used; the only known measures or standards for valuing railroad property are those that have been fixed by the Supreme Court of the United States, and they vary according to the purposes for which the valuation is made."

(4) That the Supreme Court during a period of years has been shifting its view of the meaning of value from exchange value to fair or "reasonable value" in rate making cases, thereby meaning investment cost as above stated.

It is further urged that the act was so framed as to allow the Commission making the valuation to treat the investment cost as the "reasonable value."

The result sought to be attained by those entertaining the foregoing views in the case of valuation of right of way is the exclusion from consideration of (1) lands donated to the company; (2) lands paid for out of earnings in excess of a fair

return upon the actual, reasonable cost of the property producing the earnings: (3) the use of highways and public places commonly known as franchises; (4) any value created by the union and merger of the individual parcels purchased into a continuous and homogeneous whole; (5) any value arising from the location upon great natural routes of traffic and in proximity to large and increasing demands for transportation service; (6) any appreciation in value above the actual cost, including, of course, in such actual cost expense attending acquisition, as well as the amount paid the owner.

All of the foregoing matters are proper for consideration upon the view of value held by the courts in condemnation and taxation cases and by the public universally in its business transactions. It follows that results almost incalculable are dependent upon the meaning or definition of the word value. Congress has directed the ascertainment and determination of "the *value* of all property owned or used by every common carrier" subject to the provisions of the Act to regulate commerce. That value when finally determined is to be used as a basis in rate making cases by the Commission for the reason that the Supreme Court has repeatedly held that the basis of all calculations as to the reasonableness of rates to be charged by railroad corporations is the value of the property used by them for the convenience of the public. I expressly exclude from consideration in the foregoing at this time the words "fair" and "reasonable" as qualifying value since the valuation act does not use them and repeatedly uses value unqualified by any adjective as the thing to be ascertained and determined. I shall assume that by value the Congress meant just what the Supreme Court has meant in rate making cases coming before it and that such will be the ruling in any possible litigation growing out of the valuation act.

Questions to be discussed arising from the foregoing.

Two important questions may arise concerning the views above stated.

1. Is the actual reasonable investment cost of the carriers' property used for the convenience of the public the fair and

just basis for determining the reasonableness of the rates to be charged by the carrier?

This question I shall in no wise discuss at this time. My effort has been and is to ascertain what the law of the land is and not what, theoretically, it ought to be. But to avoid any misconception of why I do not discuss the question I will say I do not think the debtor and creditor theory of Prof. Commons upon which the investment view is based is either equitable or practicable under the present organization of society and business.

2. Does the Supreme Court, either consciously or unconsciously, attach different meanings to the word value—one meaning in all classes of cases except rate making and another and a vastly different meaning in that class?

In 1893 the Supreme Court said in a condemnation case (Monongahela Nav. Co. v. United States, 148 U. S., p. 329): "So before this property can be taken away from its owners the whole value must be paid."

In 1894 in a tax case (P. C. C. & St. L. Rwy. Co. v. Backus, 154 U. S., p. 430), it was said: "And when the statute provides that such property shall be assessed at its 'true cash value' it means to require that it shall be assessed at the value which it has as used and by reason of its use."

In another tax case decided in 1894 (C. C. C. & St. L. Rwy. Co. v. Backus, 154 U. S., p. 445), it said: "The rule of property taxation is that the value of the property is the basis of taxation." In the same case at 446 it said: "Will it be said that the taxation must be based simply on the cost, when never was it held that the cost of a thing is the test of its value."

In 1898 in a rate making case (Smyth v. Ames, 169 U. S., p. 547), it said: "What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience."

In 1899 in a rate making case (San Diego v. National City, 174 U. S., p. 757), it said: "The basis of calculation suggested by the appellant is, however, defective in not requiring the real value of the property and the fair value in

themselves of the services rendered to be taken into consideration."

In 1903 in a rate making case (San Diego v. Jasper, 189 U. S., p. 439), it said: "It is no longer open to dispute that under the constitution 'what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public.'"

In 1904 in a rate case (Stanislaus Co. v. San Joaquin Co., 192 U. S., p. 215), it said: "It is not confiscation nor a taking of property without due process of law, nor a denial of the equal protection of the laws to fix water rates so as to give an income of six per cent. upon the *then value* of the property used." "We think that a law which reduces the compensation theretofore allowed to six per cent. upon the *present value* of the property used for the public is not unconstitutional."

In a rate case decided in 1909 (Knoxville v. Knoxville Water Co., 212 U. S., p. 9), it said: "The cost of reproduction is *one way* of ascertaining the present value of a plant like that of a water company."

In another rate case decided in 1909 (Willcox v. Consolidated Gas Co., 212 U. S., p. 52), it said: "If the property, which legally enters into the consideration of the question of rates, has increased *in value* since it was acquired, the company is entitled to the benefit of the increase." Again at page 50: "In such event the enforcement of the rates should be enjoined even in a case where the value of the property depends upon the value to be assigned to real estate by the evidence of experts."

In a rate case decided in 1913 (Minnesota Rate Cases, 230 U. S. P. 454), it said: "As the company may not be protected in its investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership and it is that property, and not the original cost of it which the owner may not be deprived without due process of law."

It is not denied, and, indeed, is admitted that in the tax and condemnation cases the court by value means value in

exchange. The burden logically is clearly upon those who maintain that in the rate cases it means something entirely different, to sustain their contention, but unfortunately we can not stand upon the logic of the case when confronted by an actual valuation.

This question I purpose to discuss because it is fundamental in the present valuation. It is impossible that the valuation can be carried on intelligently and justly without a clear cut conception of what is meant by value. That is what is to be ascertained and determined. Tens of millions of dollars should not be expended by the government and an equal or greater amount by the railroads for the purpose of assembling a miscellaneous lot of information gathered upon no consistent or understandable theory of what it tends to show or what use is to be made of it, except that from the vast and undigested mass an engineer, an accountant and a theorist may distil a sum upon which they think it reasonable the carrier should be allowed to earn a 6 per cent. return. It is appalling that an industry which claims to have property worth eighteen billions should be compelled to have the value of that property fixed and yet no one know what is meant by value or what is properly evidentiary of it. If the railroads do not know this they certainly can make no complaint of any determination which may be made, since they will have no standard with which to compare it. They will not be able to say it is wrong unless they can point out something different which they can justly urge to be right.

The use of the word value by the Supreme Court in rate making cases historically considered.

The regulation of railroad rates charged by existing corporations, which had theretofore been permitted to fix their own rates, began in the seventies of the last century. The first question arising therefrom coming to the Supreme Court was whether such a legislative power existed and if so, its limitations, if any. In Munn v. Illinois, 94 U. S. 113, decided in 1876, it was held that the state had power to fix the maximum charges for the storing of grain in warehouses in Chicago.

This was followed by a series of cases, about ten in number, holding that the power of regulation was limited by the condition that the maximum rate established must be a reasonable one. The point over which great controversy arose was whether the judgment of the court or of the legislature was the final one upon the question whether the maximum rate so fixed was reasonable. At first the court held that the decision lay with the legislature. As the personnel of the court changed the view changed, until in 1889 in the case C., M. & St. P. Rwy. Co. v. Minnesota, 134 U. S. 418, the court held that the question of reasonableness must be subject to judicial inquiry which in effect gives the courts the last word. Three of the judges vigorously dissented from this, but the court has subsequently in all cases adhered to the view then laid down.

But the court was never called upon to lay down and never did lay down any standard by which to test the reasonableness of a rate until 1897. In that year Smyth v. Ames, 169 U. S. 466, came before it and the supposed exigencies of the case compelled counsel on both sides to present their views as to the standard by which the rates were to be judged. After eleven months of cogitation the court handed down its opinion in which it announced two controlling principles, from which, as will hereafter be shown, it has never departed. The second of these logically and practically is nothing more than a corollary of the first. Briefly stated they are:

(1) Rates for the transportation of persons and property are primarily for legislative determination, but the question whether they are so unreasonably low as to deprive the carrier of its property without such compensation as the fourteenth amendment to the Constitution secures and therefore without due process of law, can not be so conclusively determined by the legislative authority that the matter may not become the subject of judicial inquiry.

The sole inquiry open to the courts in a rate making case being whether the challenged rates virtually work a confiscation of the property of the carrier, that is deprive it of some or all its value without just compensation, the second principle follows as a matter of necessity:

(2) That the basis of all calculation as to the reasonableness of transportation rates must be the fair value of the property being used by the carrier for the convenience of the public.

Nothing can be clearer than the reasoning by which this second principle is sustained. The court has no jurisdiction over rates established by legislative authority except to prevent confiscation of property. The physical property is not actually taken by an unreasonably low rate, but its value is taken away or destroyed. Hence, it can only be determined whether or not the rate is confiscatory, by ascertaining the value of the property affected. It is only in case such value is taken in whole or in part without just compensation that there is any confiscation.

From this it is plainly apparent that in the definition of of the word value lies the constitutional protection which is enforced by the courts and that any shift in the meaning of that word means a corresponding shift in the constitutional protection to property rights. The constitution does not protect merely some property but not all against confiscation. No property or property right is left naked and without its covering. The function of the court, according to its own repeated decisions, lies only in interposing its negative when a legislative rate does that which the constitution forbids.

I have pointed out in a preceding paragraph six distinct matters which are sought to be excluded from consideration in rate making. This means that although they may be property or property rights they are not protected by the constitutional shield and may be confiscated, and this with the acquiescence of the courts and merely because some one upon his view of what is theoretically just has reached the conclusion that the owner of such property and property rights is not justly entitled to a return upon them.

The real underlying question as to all these matters is whether they are property or property rights and have been so held by the courts. If they are, then a total disregard of them in rate making is manifestly their confiscation. The short cut to such confiscation is the verbal delusion we are considering, namely, that by value the court in rate making

cases means something different from what it means in condemnation cases, and by the simple device of narrowing a definition can sweep away rights which it elsewhere inflexibly protects. The rule upon which the court declares it ought to act is vigorously stated in Reagan v. Farmers' Loan & Trust Co., 154 U. S. 362, 399, in the following language:

> "These cases all support the proposition that while it is not the province of the courts to enter upon the merely administrative duty of framing a tariff of rates for carriage, it is within the scope of judicial power and a part of judicial duty to restrain anything which, in the form of a regulation of rates, operates to deny to the owners of property invested in the business of transportation that equal protection which is the constitutional right of all owners of other property. There is nothing new or strange in this. It has always been a part of the judicial function to determine whether the act of one party (whether that party be a single individual, an organized body or the public as a whole) operates to divest the other party of any rights of person or property. In every constitution is the guarantee against the taking of private property for public purposes without just compensation. The equal protection of the laws which, by the Fourteenth Amendment, no State can deny to the individual, forbids legislation, in whatever form it may be enacted, by which the property of one individual is, without compensation, wrested from him for the benefit of another, or of the public. This, as has been often observed, is a government of law, and not a government of men, and it must never be forgotten that under such a government, with its constitutional limitations and guarantees, the forms of law and the machinery of government, with all their reach and power, must in their actual workings stop on the hither side of the unnecessary and uncompensated taking or destruction of any private property, legally acquired and legally held."

In Smyth v. Ames, 169 U. S. 466, after an elaborate review of the authorities for the purpose of ascertaining the principles by which it could review the determination of a state legislature in a rate case, the court at page 526 laid down the principle as follows:

> "While rates for the transportation of persons and property within the limits of a State are primarily for

> its determination, the question whether they are so unreasonably low as to deprive the carrier of its property without such compensation as the Constitution secures, and therefore without due process of law, can not be so conclusively determined by the legislature of the State or by regulations adopted under its authority, that the matter may not become the subject of judicial inquiry."

This is a clear-cut statement of wherein lies the jurisdiction of the court, and this principle it has followed consistently ever since. Thus in San Diego Land and Town Co. v. National City, 174 U. S. 739, at page 754, it says:

> ". . . for the State cannot by any of its agencies, legislative, executive or judicial, withhold from the owners of private property just compensation for its use. That would be a deprivation of property without due process of law. *Chicago, Burlington, &c. Railroad v. Chicago*, 166 U. S. 226; *Smyth v. Ames*, 169 U. S. 466, 524. But it should also be remembered that the judiciary ought not to interfere with the collection of rates established under legislative sanction unless they are so plainly and palpably unreasonable as to make their enforcement equivalent to the taking of property for public use without such compensation as under all the circumstances is just both to the owner and to the public; that is, judicial interference should never occur unless the case presents, clearly and beyond all doubt, such a flagrant attack upon the rights of property under the guise of regulations as to compel the court to say that the rates prescribed will necessarily have the effect to deny just compensation for private property taken for the public use."

Again in one of its latest utterances, in the Minnesota Rate Cases, 230 U. S. 352, at page 434, it says:

> "But the State has not seen fit to undertake the service itself; and the private property embarked in it is not placed at the mercy of legislative caprice. It rests secure under the constitutional protection which extends not merely to the title but to the right to receive just compensation for the service given to the public."

At page 458, it makes further reference to its power in rate cases, in saying:

> "It must be remembered that we are concerned with a charge of confiscation of property by the denial of a fair return for its use."

What the Supreme Court protects against confiscation.

The function of the Supreme Court in rate making cases is to protect the use and enjoyment of property against confiscation. In the case of interstate rates established directly by Congress or through its instrument, the Interstate Commerce Commission, the Constitutional protection is afforded by the fifth amendment; in the case of intrastate rates by the fourteenth amendment. Under either the protection to be given is precisely the same. It is also the same as that given when the physical property is taken by condemnation proceedings. There is not the slightest difference in principle. Property is not to be created or taken away by the court in either case. Its sole duty is to prevent the taking away for a public use unless a just compensation is made. We may, therefore, properly inquire as to the holdings of the court in condemnation cases for the purpose of learning what it protects.

Boom Company v. Patterson, 98 U. S. 403, was decided in 1878. The Boom Company was authorized by the law of Minnesota to condemn lands for boom purposes. The defendant owned an entire island and parts of two other islands in the Mississippi river. The land owned by him amounted to a little over thirty-four acres and embraced the entire shore line of the three islands with the exception of about three rods. The position of the islands especially fitted them in connection with the west bank of the river to form a boom of extensive dimensions. The company sought to condemn the defendant's land on these islands, with the result that the defendant obtained an award of $5,000, a special verdict fixing the value of the land aside from any consideration of its value for boom purposes at $300. So the defendant was awarded $4,700 for the adaptability to boom purposes. The Boom Co. appealed and the question before the court was what the owner of the land was entitled to. The court said (p. 408):

> "The inquiry in such cases must be what is the property worth in the market, viewed not merely with reference to the uses to which it is at the time applied, but with reference to the uses to which it is plainly adapted; that is to say, what is it worth from its availability for valuable uses. Property is not to be deemed worthless because the owner allows it to go to waste, or to be regarded

> as valueless because he is unable to put it to any use. Others may be able to use it, and make it subserve the necessities or conveniences of life. Its capability of being made thus available gives it a market value which can be readily estimated.
>
> "So many and varied are the circumstances to be taken into account in determining the value of property condemned for public purposes that it is perhaps impossible to formulate a rule to govern its appraisement in all cases. Exceptional circumstances will modify the most carefully guarded rule; but, as a general thing, *we should say that the compensation to the owner is to be estimated by reference to the uses for which the property is suitable*, having regard to the existing business or wants of the community, or such as may be reasonably expected in the immediate future.
>
> "The position of the three islands in the Mississippi fitting them to form, in connection with the west bank of the river, a boom of immense dimensions, capable of holding in safety over twenty millions of feet of logs, added largely to the value of the lands. The boom company would greatly prefer them to more valuable agricultural lands, or to lands situated elsewhere on the river; as by utilizing them in the manner proposed, they would save heavy expenditures of money in constructing a boom of equal capacity. Their adaptability for boom purposes was a circumstance, therefore, which the owner had a right to insist upon as an element in estimating the value of his lands."

The judgment below was affirmed. It needs no argument to show that what was protected here was the value of the property and that in ascertaining that value the adaptability of the lands to boom purposes was an element which was recognized and compensation therefor given.

Monongahela Navigation Co. v. United States, 148 U. S. 312, decided in 1892, four of the judges sitting in Smyth v. Ames participating in the decision, involved the condemnation of a lock and dam on the Monongahela river owned by the company, by the United States. The company had the right to collect tolls for the use of the lock. The award was $209,000, "not considering or estimating in this decree the franchise of this company to collect tolls." The company appealed, not contending, however, that the physical lock and dam had been

undervalued, but averring that "the present value of the lock and dam is not less than $450,000, said value being predicated upon present and prospective tolls." The court reversed the award and ordered a new trial. Congress had specially enacted that in said proceeding "the franchise of said corporation to collect tolls shall not be considered or estimated." Regarding this the court observed:

> "By this legislation, Congress seems to have assumed the right to determine what shall be the measure of compensation. But this is a judicial and not a legislative question. The legislature may determine what private property is needed for public purposes—that is a question of a political and legislative character; but when the taking has been ordered, then the question of compensation is judicial. It does not rest with the public, taking the property, through Congress or the legislature, its representative, to say what compensation shall be paid, or even what shall be the rule of compensation. The Constitution has declared that just compensation shall be paid, and the ascertainment of that is a judicial inquiry."

On the merits of the controversy, the court said (p. 328):

> "How shall just compensation for this lock and dam be determined? What does the full equivalent therefor demand? The value of property, generally speaking, is determined by its productiveness—the profits which its use brings to the owner. Various elements enter into this matter of value. Among them we may notice these: Natural richness of the soil as between two neighboring tracts—one may be fertile, the other barren; the one so situated as to be susceptible of easy use, the other requiring much labor and large expense to make its fertility available. Neighborhood to the centres of business and population largely affects values. For that property which is near the centre of a large city may command high rent, while property of the same character, remote therefrom, is wanted by but few, and commands but a small rental. Demand for the use is another factor. The commerce on the Monongahela river, as appears from the testimony offered, is great; the demand for the use of this lock and dam constant. A precisely similar property, in a stream where commerce is light, would naturally be of less value, for the demand for the use would be less. *The value, therefore, is not determined by the mere cost of construction,* but more by what the completed structure brings in the way of earnings to its owner. *For each separate use of one's property by others, the owner is entitled to a reasonable compensation; and the number and amount of such uses determine the productiveness and the earnings of the property, and, therefore, largely its value.*"

Also at page 329:

> "So, before this property can be taken away from its owners, the whole value must be paid; and that value depends largely upon the productiveness of the property, and the franchise to take tolls."

This was a property devoted to a public use and I think it may be assumed, although not expressly stated, that the $209,000 awarded was not less than the amount of the company's investment. This did not weigh with the court, and in language not to be misconstrued, or whittled away, it protected the value of the property and declared that an element which could not be disregarded was the number and amount of uses of it which the company could sell.

United States v. Chandler-Dunbar Co., 229 U. S. 53, was decided as late as May, 1913. The government sought to condemn certain property at Sault Ste. Marie in Michigan for canal and lock purposes. It excepted to the inclusion as an element of value the availability of certain lands for lock and canal purposes. As to this the court said (p. 76):

> "The exception taken to the inclusion as an element of value of the availability of these parcels of land for lock and canal purposes must be overruled. That this land had a prospective value for the purpose of constructing a canal and lock parallel with those in use had passed beyond the region of the purely conjectural or speculative. That one or more additional parallel canals and locks would be needed to meet the increasing demands of lake traffic was an immediate probability. This land was the only land available for the purpose. It included all the land between the canals in use and the bank of the river. Although it is not proper to estimate land condemned for public purposes by the public necessities or its worth to the public for such purpose, it is proper to consider the fact that the property is so situated that it will probably be desired and available for such a purpose. Lewis on Eminent Domain, §707. *Boom Co. v. Patterson,* 98 U. S.

403, 408; *Shoemaker v. United States,* 147 U. S. 282; *Young v. Harrison,* 17 *Georgia,* 30; *Alloway v. Nashville* 88 Tenn. 510; *Sargent v. Merrimac,* 196 Massachusetts, 171."

Here availability for a particular as well as for general uses is recognized as an element of value which must be protected.

In each of these cases the court sets up no definition of value. It assumes that its meaning is too well settled to require definition. It leaves no doubt either by its language or the point adjudicated as to what it means and what it is protecting. It says that certain things must be considered when the government or a corporation seeks to take private property for a public use because those things are protected as elements of property value by the constitutional provisions.

Stripped of all verbiage the position against which I am contending is that the identical elements of value protected in the cases I have cited are not to be protected when the taking of property is done under the form of rate making. In other words what constitutes property when the government endeavors to deprive the owner of it in one form of proceeding is not property when it attempts the taking in another form of proceeding. And this latter is justified by merely saying the court has shifted its position, has undergone a transition as to the meaning of the word value! I leave it to others to say how much reliance is to be placed on constitutional guarantees if they can be nullified by a newly manufactured definition of a word.

The court's position in taxation cases.

"The rule of property taxation is that the value of the property is the basis of taxation." (C. C. C. & St. L. Ry. Co. v. Backus, 154 U. S., p. 445.) It clearly follows from this that whatever the court decides constitutes the value of property for taxation purposes is a property right which is under the protection of the constitutional guarantee against confiscation. It would require great audacity to argue that what is a property value when taking money from the owner for governmental purposes is not a property value upon which the owner is to be allowed to earn a return for the purposes of paying

the tax. A review of what the court has said in taxation cases is in order.

In Columbus Southern Railway Co. v. Wright, 151 U. S. 470, decided in 1894, the court adopted certain language relating to value for taxation from a Tennessee case, as follows:

> "The roadway itself of a railroad depends for its value upon the traffic of the company and not merely upon the narrow strip of land appropriated for the use of the road, and the bars and cross-ties thereon. The value of the roadway at any given time is not the original cost, nor, *a fortiori,* its ultimate cost after years of expenditure in repairs and improvements. On the other hand, its value can not be determined by ascertaining the value of the land included in the roadway assessed at the market price of adjacent lands, and adding the value of the cross-ties, rails and spikes. The value of land depends largely upon the use to which it can be put and the character of the improvements upon it. The assessable value, for taxation, of a railroad track can only be determined by looking at the elements on which the financial condition of the company depends, its traffic, as evidenced by the rolling stock and gross earnings in connection with its capital stock."

Whatever the value established by this view is the value of the property, and that is beyond the reach of confiscation in rate making.

In P. C. C. & St. L. Rwy. Co. v. Backus, 154 U. S. 421, decided in 1894, the court again quotes with approval the foregoing language and further expressed itself at page 430 as follows:

> "And when the statute provides that such property shall be assessed at its 'true cash value' it means to require that it shall be assessed at the value which it has, as used, and by reason of its use."

In C. C. C. & St. L. Rwy. Co. v. Backus, 154 U. S. 439, at page 444, the court uses language which I have quoted in pamphlet No. 1, but which will well bear repetition here:

> "The true value of a line of railroad is something more than an aggregation of the values of separate parts of it, operated separately. It is the aggregate of those values plus that arising from a connected operation of the whole, and each part of the road contributes not merely the

value arising from its independent operation, but its mileage proportion of that flowing from a continuous and connected operation of the whole. This is no denial of the mathematical proposition that the whole is equal to the sum of all its parts, because there is a value created by and resulting from the combined operation of all its parts as one continuous line. This is something which does not exist, and cannot exist, until the combination is formed. A notable illustration of this was in the New York Central Railroad consolidation. Many years ago the distance between Albany and Buffalo was occupied by three or four companies, each operating its own line of road, and together connecting the two cities. The several companies were united and formed the New York Central Railroad Company, which became the owner of the entire line between Albany and Buffalo and operated it as a single road. Immediately upon the consolidation of these companies and the operation of the property as a single connected line of railroad between Albany and Buffalo the value of the property was recognized in the market as largely in excess of the aggregate of the values of the separate properties."

At page 445 it said:

"The rule of property taxation is that the value of the property is the basis of taxation. It does not mean a tax upon the earnings which the property makes, nor for the privilege of using the property, but rests solely upon the value. But the value of property results from the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines the value, and if property is taxed at its actual cash value it is taxed upon something which is created by the uses to which it is put."

At page 446 it said:

"Will it be said that the taxation must be based simply on the cost, when never was it held that the cost of a thing is the test of its value? Suppose there be two bridges over the Ohio, the cost of the construction of each being the same, one between Cincinnati and Newport and another twenty miles below and where there is nothing but a small village on either shore. The value of the one will, manifestly, be greater than that of the other, and that excess of value will spring solely from the larger

use of the one than of the other. Must an assessing board in either State, assessing that portion of the bridge within the State for purposes of taxation, eliminate all of the value which flows from the use and place the assessment at only the sum remaining? It is a practical impossibility."

In these expressions the court very justly recognizes that the union of a large number of parcels bought from separate owners into a homogeneous whole, used for a purpose of which the separate parcels are not capable, creates a value which did not exist prior to the union. It also justly recognizes that location is an element of value when such location ensures a demand for use. Such values are property. In taxation cases the owner must pay upon them. In condemnation cases he must be paid for them. How is it possible for the court whose function it is to protect these property rights against confiscation to say they do not exist when it comes to the right of the owner to earn a return upon them?

In Adams Express Co. v. Ohio State Auditor, 165 U. S. 194, decided in 1897, and in the application for a rehearing therein decided the same year, 166 U. S. 165, the court in most decisive manner reiterated its apparently well considered and well settled views as to the value of property for taxation. I content myself with one quotation from the opinion in 166 U. S. at page 220:

"Now it is a cardinal rule which should never be forgotten that whatever property is worth for the purposes of income and sale it is also worth for purposes of taxation. Suppose such a bridge were entirely within the territorial limits of a State, and it appeared that the bridge itself cost only $1,277,000, could be reproduced for that sum, and yet it was so situated with reference to railroad or other connections, so used by the travelling public, that it was worth to the holders of it in the matter of income $2,900,000, could be sold in the markets for that sum, was therefore in the eyes of practical business men of the value of $2,900,000, can there be any doubt of the State's power to assess it at that sum, and to collect taxes from it upon that basis of value? Substance of right demands that whatever be the real value of any property, that value may be accepted by the State for purpose of taxation, and this ought not to be evaded by any mere confusion of words."

Attention need only be called to the statement that whatever property is worth for the purpose of income and sale it is also worth for the purpose of taxation. Whatever it is worth for income and sale must be paid for it in condemnation proceedings. What must be paid in condemnation proceedings is the value of the property of which the owner can not be deprived without just compensation. If such value is $1,000 and the property cost but $500, or in other words that is the amount of the invesment and the owner is allowed to earn a return upon only $500, has there or has there not been a confiscation of the remaining $500? If the property is taxed at $1,000 and the return confined to $500, what is the exaction of a tax upon the other $500 to be called?

One more query only is required to direct attention sharply to the fundamental question involved: Is it possible to work confiscation of property by using a new definition for the word value wholly unknown for any purpose except rate making?

What the Supreme Court has said and decided in rate making cases.

Eight cases have been decided by the Supreme Court which involve rate making and cast light upon the present discussion. The following is the list with the year in which the cases were decided:

1. Smyth v. Ames, 169 U. S. 466 (1898).
2. San Diego Land and Town Co. v. National City, 174 U. S. 739 (1899).
3. San Diego Land and Town Co. v. Jasper, 189 U. S. 439 (1903).
4. Stanislaus Co. v. San Joaquin Co., 192 U. S. 201 (1904).
5. City of Knoxville v. Knoxville Water Co., 212 U. S. 1 (1909).
6. Willcox v. Consolidated Gas Co., 212 U. S. 19 (1909).
7. Minnesota Rate Cases, 230 U. S. 352 (1913).
8. San Joaquin Company v. Stanislaus County, 233 U. S. 454 (1914).

In Appendix "A" will be found a full review of these cases, showing what was urged upon the court, what the court said

and what it decided in each case. A summary of what these cases show may well be given at this point.

1. There is not an intimation in any case that the court is using the term value in sense different from that given it in condemnation and taxation cases.

2. It has declined to hold that cost is the value of the property, although consistently holding that it is an element which may be considered in fixing value.

3. It has decided that when property or rights are owned in fact it is immaterial whether the owner paid anything for them or not. Their value must be respected in fixing the rate.

4. It has decided that in ascertaining present value it is not limited to the amount of the actual investment. That the making of a just return for the use of property involves the recognition of appreciation in value.

5. It has declined to hold that cost of reproduction is necessarily the value of property.

6. It has held that cost of reproduction is one way or method of ascertaining value.

7. It holds that a variety of matters is to be considered in fixing value, which is, of course, wholly inconsistent with the view that but one matter, namely, amount of investment, is the sole test.

8. It holds that the ascertainment of value is the exercise of a reasonable judgment having its basis in a proper consideration of all relevant facts.

None of these is in any degree inconsistent with the view of value held by the court in condemnation and tax cases; they are all based by necessary implication upon that view; they all find their support in the commonly accepted view of value as value in exchange. To state the matter in another way. I have hereinbefore set forth six distinct matters which it is sought to exclude from consideration in rate making cases by this manufactured definition of value. Three of these, (1) property donated to the company; (2) property paid for out of earnings; (6) appreciation in value above actual cost, the court has passed upon definitely and decisively

and in so doing has proceeded upon a view which is decisive of the others.

It may possibly be objected that I have in this discussion omitted any consideration of the adjectives "fair" and "reasonable," prefixed by the court in laying down the rule. If so there are two sufficient answers. First, if "reasonable value" means something essentially different from "value" then we are to note that the valuation act does not require the "reasonable value" to be ascertained by the commission, but merely "the value." Second, "value," "fair value," "reasonable value" and "true value" all mean obviously the same thing to the court. In Smyth v. Ames the court says in one sentence "fair value." In both the second and third sentences thereafter it uses "value" without any adjective to express precisely the same thought. So in the Minnesota Rate Cases (230 U. S.), at page 434, the court uses "fair value" and "reasonable value," citing the cases where such language had been used, but on page 458 it says: "It must be remembered that we are concerned with a charge of confiscation of property by the denial of a fair return for its use; and to determine the truth of the charge there is sought to be ascertained the present value of the property." Here is an utter unconsciousness that the court has shifted its ground by omitting both "fair" and "reasonable." So repeatedly in this opinion the court speaks of value in such connection as to show that the use of the adjective is wholly immaterial. Other illustrations might be given, but it is unnecessary.

Summary of the foregoing.

The thought herein presented when properly understood will be seen to be very comprehensive, and a concise summary, although involving repetition, will be useful.

1. The function of the courts in rate making cases is solely the protection of property against confiscation, which protection it can give only by annulling rates which are so low as to amount in their practical result to the taking of private property without just compensation.

2. In all cases other than rate making ones the test of unlawful taking is whether the owner is deprived of the value of his property, and the test of just compensation is whether he has been given that value.

3. If the owner is deprived of the value of his property or of a reasonable return upon that value by a rate established by legislative action he is deprived of his property within the meaning of the constitutional prohibition.

4. If in such a case the court can exclude from consideration certain elements or factors which in every other proceeding it declares to be elements of value and property rights, by setting up a new definition of value hitherto unknown, then it can and does assist in the confiscation of a value, of a property right which it elsewhere protects and which it elsewhere lays burdens upon by way of taxation.

5. In short, that no court has the lawful right to aid in the confiscation of property or lend its sanction thereto by merely changing for that case only the settled meaning of a word as repeatedly and emphatically laid down by itself.

In urging that the court can not exercise any such power and has not assumed to do so, I am in effect pointing out in the most convincing way known to me that whenever railroad corporations or those engaged in protecting their just rights permit any deviation in the use of the word value from that meaning repeatedly and uniformly given to it by the Supreme Court, they throw away every protection given by the constitutional guarantees, they give full opportunity for the exploitation and possible enforcement of any visionary scheme which the ingenuity of man can devise as to the return which railroad properties should be permitted to earn. Further, that in the pending valuation they deprive themselves of any remedy against any result which may be reached, no matter how injurious it may be to their credit, since nothing can be plainer than if they have no fixed and certain meaning for value they will be unable to contend successfully that the figure fixed upon by the Commission is not the "value" which Congress has directed to be ascertained.

These truths are so patent that it ought not to be necessary to hammer upon them with infinite repetition. If the Com-

mission should declare the value of right of way to be per acre that of contiguous lands, and when such contiguous lands have no value the right of way has none, how can that determination be overthrown unless it fails to accord with some definite idea or definition of value? If it says that the actual cost is the value, how is that to be contested unless upon the view that thereby some element of value has been disregarded to which the owner of the property is entitled as a property right? The cry of the lack of a definition of value is a confession that there is no standard by which to judge of property rights. It remits the whole problem of valuation to an uncontrolled and irresponsible discretion, which can reach any result, sound or unsound, fantastic or otherwise, without any possibility of review. Nay, more. If one has no clear-cut and definite idea of what the value directed to be ascertained is, his very muddiness on that will absolutely preclude him from being of any assistance to the Commission in reaching its determination. Any insistence upon the consideration of a particular thing as an element of value is impossible without a definition of value, for without that definition there is no possibility of saying that it is in truth and fact such an element. Those who entertain the view that value means investment cost have at least the merit of a definite notion. They would have no difficulty in rejecting appreciation or location as relevant matters which should be considered in reference to right of way, nor in saying why they rejected them. The Supreme Court has said that valuation is an act of judgment in which all relevant matters are to be considered. What can one say is a relevant matter unless he has a notion of what value is?

I have persistently put out my notion of value and have supported my view by such appeals to authority as I thought conclusively established my contention. If I am right that definition of value should be adhered to, and the methods of ascertaining it should be worked out. If I am not right some other definition should be proposed, subjected to all proper analysis and just criticism, and if approved should be rigidly followed in the methods to be adopted for its ascertainment. The method necessarily depends upon the idea; the idea

can only be known through the medium of an accurate definition.

I repeat the only legal protection railroad corporations have against the confiscation of their property, as they regard it, lies in the definition of the word value. That is the yardstick which measures everything. How long is it? If courts or commissions can and do say that in all but one case it is 36 inches, but in that one case it is a fewer number, with an uncontrolled power to say how many fewer, the result is too plain for discussion.

APPENDIX A.

Smyth v. Ames, 169 U. S. 466.

Decided March 7, 1898. Opinion by Justice Harlan; Gray, Brewer, Brown, Shiras, White and Peckham concurring.

The rule laid down by the court in this case has been quoted so frequently as to render its repetition at this place unnecessary. It is proper, however, to observe that in deciding the case before it the court did not pass upon the value of the properties involved.

1. At the time this case was decided "value" had a well established and uncontroverted meaning in general use, economic use and judicial decisions which was beyond doubt known to the members of the court. They give no intimation that they use the word in other than its accepted sense.

2. The court lays down certain matters which must be considered in ascertaining value. The consideration of all these matters and the giving to each of them such weight as may be just in a given case is wholly inconsistent with the investment theory of value and entirely consistent with the ascertainment of exchange value.

3. The members of the court sitting in the case had within the five previous years decided at least six cases in which they had found occasion to consider "value," and they had defined and illustrated it in the most forcible way, as the citations hereinbefore made clearly show. They, beyond a shadow of doubt, considered value in those cases to be value in exchange. That they abandoned the signification of which they had given such clear illustration and set up another as a rule by which to measure the confiscation of property is altogether beyond the boundaries of rational belief.

4. In setting up a rule to prevent confiscation of property it is at least improbable that they intended to withdraw from its protection that which they had previously and in the most emphatic way declared to be property.

San Diego Land and Town Company v. National City, 174 U. S. 739.

This case, decided May 22nd, 1899, was the first case involving rates to come before the Supreme Court subsequent to the decision in Smyth v. Ames. The opinion was by Mr Justice Harlan, who wrote in Smyth v. Ames, and the court had precisely the same membership as in that case. The case was this: The San Diego Land and Town Company, a Kansas corporation, filed a bill in the Circuit Court of the United States for the Southern District of California against National City. An act of the Legislature of California had authorized the Board of Aldermen or other legislative body of the city to fix the rates that should be charged and collected by any corporation for water furnished to it. By an ordinance of the Board of Trustees of the defendant city certain rates of compensation to be collected by corporations for the use of water supplied to the city or its inhabitants were fixed for the year beginning July 1st, 1895. The bill questions the validity of the ordinance, and the relief asked was a decree adjudging that the rates fixed by the defendant city were void, it being alleged among other things that the proceedings of the defendant's board of trustees under them were in violation of the Constitution of the United States, and particularly of the first section of the fourteenth amendment. The defendant answered, and the cause having been heard upon the pleadings and proofs, the bill was dismissed. The case came before the Supreme Court upon an appeal from this decree. Several questions were presented to and discussed by the court, which have no relation to the matter in hand. The pertinent matters are as follows: At page 753 the court says:

> "It is equally clear that this power (to fix rates) could not be exercised arbitrarily and without reference to what was just and reasonable as between the public and those who appropriated water and supplied it for general use; for the State cannot by any of its agencies, legislative, executive or judicial, withhold from the owners of private property just compensation for its use. That would be a deprivation of property without due process of law."

The court added to this the following:

> "But it should also be remembered that the judiciary

ought not to interfere with the collection of rates established under legislative sanction unless they are so plainly and palpably unreasonable as to make their enforcement equivalent to the taking of property for public use without such compensation as under all the circumstances is just both to the owner and to the public; that is, judicial interference should never occur unless the case presents, clearly and beyond all doubt, such a flagrant attack upon the rights of property under the guise of regulation as to compel the court to say that the rates prescribed will necessarily have the effect to deny just compensation for private property taken for the public use."

It then pursued the inquiry as follows:

"What elements are involved in the general inquiry as to the reasonableness of rates established by law for the use of property by the public? This question received much consideration in *Smyth v. Ames*, above cited."

It states what was decided in that case, and among other quotations it makes is the following:

"If a railroad corporation has bonded its property for an amount that exceeds its fair value, or if its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds and obligations, is not alone to be considered when determining the rates that may be reasonably charged."

In quoting this language from its former decision the court adheres to its opinion that stocks, bonds and obligations are to be considered in valuation cases, but are not the only matters entitled to consideration. After discussing other cases the court comes down directly to the case in hand and says at page 757:

"The contention of the appellant in the present case is that in ascertaining what are just rates the court should take into consideration the cost of its plant; the cost per annum of operating the plant, including interest paid on money borrowed and reasonably necessary to be used in constructing the same; the annual depreciation of the plant from natural causes resulting from its use, and a fair profit to the company over and above such charges

for its services in supplying the water to consumers, either by way of interest on the money it has expended for the public use, or upon some other fair and equitable basis. Undoubtedly all these matters ought to be taken into consideration, and such weight be given them, when rates are being fixed, as under all the circumstances will be just to the company and to the public. The basis of calculation suggested by the appellant is, however, defective in not requiring the *real value* of the property and the fair value in themselves of the services rendered to be taken into consideration. What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property *at the time it is being used for the public*. The property may have cost more than it ought to have cost, and its outstanding bonds for money borrowed and which went into the plant may be in excess of the real value of the property. So that it cannot be said that the amount of such bonds should in every case control the question of rates, although it may be an element in the inquiry as to what is, all the circumstances considered, just both to the company and to the public."

This is all there is in the opinion of the court upon the question now under consideration. There are other questions discussed, the evidence is analyzed and the court concludes with the following observation:

"It is sufficient to say that upon a careful scrutiny of the testimony our conclusion is that no case is made that will authorize a decree declaring that the rates fixed by the defendant's ordinance, looking at them in their entirety—and we cannot properly look at them in any other light—are such as amount to a taking of property without just compensation, and therefore to a deprivation of property without due process of law."

The Water Company was standing upon the cost of the property to it as the essential basis of its rates. The court repudiated this as the correct basis, observing that this basis of calculation was defective in not requiring "the *real value of the property* and the fair value in themselves of the services rendered to be taken into consideration."

It says:

"What the company is entitled to demand, in order

that it may have just compensation, is a fair return upon the reasonable value of the property *at the time it is being used for the public.*"

This language "at the time it is being used for the public" has no force or meaning except as it is a recognition that the value of property may change from time to time, and this from other reasons than additions to its cost. It may be less or more than the cost, which is, however, an element to be considered. There is in this case no reasoning or dictum which indicates in any degree that the court entertained any view of value other than that which its members had so frequently expressed.

San Diego Land & Town Company v. Jasper, 189 U. S. 439.

Decided April 6, 1903. Opinion by Justice Holmes; concurred in by Harlan, Brewer, Brown, White and Peckham, who sat in Smyth v. Ames.

The plaintiff brought a bill in equity in the Circuit Court for the Southern District of California against the Board of Supervisors of San Diego County and others for the purpose of having certain water rates which had been fixed by the board declared void. It was alleged that the rates were so low as to amount to a taking of the plaintiff's property without due process of law. The Circuit Court decided that it did not appear that the rates would have that effect and dismissed the bill, whereupon the plaintiff appealed to the Supreme Court, which affirmed the decree of the court below.

The court said: "The main object of attack is the valuation of the plant. It no longer is open to dispute that under the Constitution 'what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public,'" quoting the National City case. It further says: "That is decided, and is decided as against the contention that you are to take the actual cost of the plant, annual depreciation, etc., and to allow a fair profit on that footing over and above expenses." It further says: "No doubt cost may be considered, and will have more or less

importance, according to circumstances. In the present case it is evident for reasons, some of which will appear in a moment, that it has very little importance indeed."

The court then proceeds to discuss certain transactions in the history of the company, and says: "Then, by arrangement with the stockholders who were willing to go on, the mortgage was foreclosed and all the property" (of which the water works property was estimated to constitute about one-fourth of the total value) "was sold to those stockholders for the nominal sum of $889,163.33, which was equal to the amount of outstanding certificates and bonds, and was paid by turning them in. This was in 1897, a few months before the passage of the ordinance complained of. The purchasers organized the present corporation, and the above-mentioned sum is the cost of the land and water works to it. The appellant protests that this is not a fair value for the property of the company. We doubt whether it is not a liberal allowance. The officers of the two companies at the time thought that they got more than they could have got in any other way. *But, at all events, it is decided that the price is evidence, we might say more important evidence than the original cost. Dow v. Beidelman,* 125 U. S. 680. If the supervisors were convinced by it we certainly could not say, as matter of law, that they were wrong."

This is a direct recognition by the court that the value of property is what it will bring at a sale.

In considering another question, the court says: "Of course, it is hard to answer the proposition that value expressed in money depends on what people think at the time, that determines what they will give for the thing, and whether they think rightly or wrongly, if they or some of them will give a certain price for it, *that is its value then.*"

This language, used by a court which had just declared that just compensation is a fair return upon the reasonable value of the property at the time it is being used for the public, is conclusive evidence as to what the court thought to be reasonable value. It nevertheless proceeded to hold that subsequent events might correct the view of the public and show that the property was of less value than esteemed to be.

At page 445 it says:

> "If the price paid by the present company for all the property was the fair value, the evidence available, such as the proportion between the valuations of the different parts by the company, the proportion between the assessment and taxation of the different parts and the testimony of an expert, indicates that the supervisors were liberal in valuing the plant at $350,000."

The following points were decided in this case:

1. That the original cost of the property was not conclusive as to its value.

2. That cost may be considered in a valuation of a property and will have more or less importance, according to the circumstances.

3. That the price the property brought at a public foreclosure sale was evidence of such a nature as to satisfy the court that the valuation attacked was not confiscatory.

4. That value expressed in money depends on what people think at the time.

Stanislaus County v. San Joaquin and King's River Canal and Irrigation Company, 192 U. S. 201.

This case was decided January 18th, 1904; the opinion was by Peckham, Justice; Harlan, Brewer, Brown and White were also in the case, making five of the judges concurring in this opinion, who sat in Smyth v. Ames.

Regarding this case, Professor Commons remarks in his statement on page 87:

> "Now during this period, following the ad valorem tax cases down to the present, or down to the last four or five years—you might say down to the time of the Stanislaus case, decided in 1902, which came up from California—the court was very undecided as to what were the elements of value which should be taken into account."

This alleged lack of decision on the part of the court wholly fails to appear in any of the cases reviewed, if it be assumed that when the court said value it meant precisely what it always meant and was wholly unaware that it was assuming to change the meaning of the word. Whether it is meant that

the court was still undecided as to the meaning of its own language at the time of the decision in the Stanislaus case, which is two years later than stated by Mr. Commons, I do not know, but a brief analysis of the case will show just what the court did decide and did not decide.

The case came to the court on an appeal from a decree of the Circuit Court of the United States for the Northern District of California, setting aside an ordinance of Stanislaus County in 1896, designating the water rates which were to be charged by the water company to its water consumers for the ensuing year. The court reversed the judgment of the Circuit Court and dismissed the bill without prejudice. One contention of the Water Company was that certain legislation of the State of California amounted to a contract with the company that rates should not be reduced below a certain point. This was the effect given to the legislation by the Circuit Court below, but the Supreme Court decided adversely to the contention and held that such legislation did not amount to a contract. Coming down to the question of confiscation, the court said at page 215:

> "Judging by this record, we are unable to say the Board of Supervisors failed to provide just and fair compensation for the use of the property by the public."

The board was directed by the California statute under which it acted to take into consideration the value of the property. There is not the slightest intimation in the case that the Supreme Court considered this word value as used in the statute or as used by itself in the discussion of the facts to have any other than the usual or ordinary meaning of the word. Among other things it said:

> "It is not confiscation nor a taking of property without due process of law, nor a denial of the equal protection of the laws, to fix water rates so as to give an income of six per cent. upon the *then value* of the property actually used, for the purpose of supplying water as provided by law, even though the company had prior thereto been allowed to fix rates that would secure to it one and a half per cent. a month income upon the capital actually invested in the undertaking. If not hampered by an unalterable contract, providing that a

certain compensation should always be received, we think that a law which reduces the compensation theretofore allowed to six per cent. upon the *present value* of the property used for the public is not unconstitutional. There is nothing in the nature of confiscation about it."

It is to be observed that the court speaks of the "then value" and the "present value" unencumbered by any adjective or epithet of any description. This by necessary implication recognizes that value may change.

The court discussed what is shown in the case to have been the cost of the property, but says that such cost was largely proved only by the books of the company, and observed: "What such books did not prove was the reasonableness of that cost, its propriety or necessity."

At page 215 it cites the San Diego cases and the case of Smyth v. Ames and the remarks in those cases that the cost of the plant with certain other matters undoubtedly ought to be taken into consideration and such weight given them as would be just to the company and to the public, but it observes:

> "After taking such facts into consideration, the company might still be directed to receive rates that would be nothing more than a fair and just compensation or return upon the reasonable value of the property at the time it was being used for the supplying of the water to the public."

There is nothing here to indicate any uncertainty upon the part of the court, nor is there any intimation that it had the slightest consciousness that it was shifting its opinion upon any question, least of all upon the meaning of the term value. It speaks indeed of reasonable value, but there is not anything to indicate that by reasonable value is meant reasonable cost, while there is underlying the whole discussion the apparent thought of the court that all of a large number of facts should be considered in fixing the "then value" or the "present value" or the "reasonable value" of the property of the company.

Its decision was only to the effect that there was no evidence clearly and conclusively showing that the rates assailed were confiscatory.

City of Knoxville v. Knoxville Water Company, 212 U. S. 1.

This is the next case in chronological order; it was decided January 4th, 1909, four of the judges sitting in Smyth v. Ames concurring in the decision, Peckham, Harlan, Brewer and White, the opinion being by Justice Moody.

In his statement at page 86, Professor Commons refers to the latest cases as being the Consolidated Gas Company case in New York and the Knoxville Water case, which he says were decided within the last two years. As a matter of fact, these cases were decided more than four years before the hearing. But being the then latest cases, if the court had been making a transition since 1889; if it had been shifting its ground as to what is the value for rate fixing purposes, that fact ought to begin to crop out in this case, if anywhere.

The case was this: The Knoxville Water Company brought a bill in equity in 1901 to restrain the enforcement of a city ordinance fixing in detail the maximum rates to be charged by the company. The court below held that the rates fixed were unreasonable and void, and from such decree the city appealed to the Supreme Court. At page 9 the court says:

> "The first fact essential to the conclusion of the court below is the valuation of the property devoted to the public uses, upon which the company is entitled to earn a return."

After giving certain facts not necessary to be repeated here, it further says:

> "This valuation was determined by the master by ascertaining what it would cost, at the date of the ordinance, to reproduce the existing plant as a new plant. The cost of reproduction is *one way* of ascertaining the present value of a plant like that of a water company, but that test would lead to obviously incorrect results, if the cost of reproduction is not diminished by the depreciation which has come from age and use. The company contends that the master, in fixing upon the valuation of the tangible property, did make an allowance for depreciation, but we are unable to agree to this."

On page 10 it further says:

> "The cost of reproduction is not always a fair measure of the present value of a plant which has been in use for

many years. The items composing the plant depreciate in value from year to year in a varying degree."

After adding further remarks upon this point, it says:

"But it is clear that some substantial allowance for depreciation ought to have been made in this case."

In this there does not appear to be any uncertainty as to the meaning of the court. It is recognized that the cost of reproduction is a method of ascertaining "the present value of a plant," but only one method. The case was reversed upon the ground that in that particular instance depreciation of the plant was not allowed. Here the only shifting of opinion seems to be that the court uses present value instead of fair value or reasonable value, showing again that no particular importance is attached to the adjective in any case except as elsewhere decided. It must be the value of the property at the time it is used in the service of the public, which is to be considered.

There is another point in the case which also casts some light upon value. On page 11 the court says:

"Counsel for the company urge rather faintly that the capitalization of the company ought to have some influence in the case in determining the valuation of the property. It is sufficient answer to this contention that the capitalization is shown to be considerably in excess of any valuation testified to by any witness, or which can be arrived at by any process of reasoning."

It further says:

"The cause for the large variations between the real value of the property and the capitalization in bonds and preferred and common stock is apparent from the testimony. All, or substantially all, the preferred and common stock was issued to contractors for the construction of the plant, and the nominal amount of the stock issued was greatly in excess of the true value of the property furnished by the contracts. A single instance taken from the testimony will illustrate this. At the very start of the enterprise a contract was entered into for the construction of a part of the plant, which was of a value slightly, if at all, exceeding $125,000. The price paid the contractor was $125,000 in bonds and $200,000 in

common stock. Other contracts for construction showed a like disproportion between value furnished and nominal capitalization received for that value. It perhaps is unnecessary to say that such contracts were made by the company with persons who, at the time, by stock ownership, controlled its action. Bonds and preferred and common stock issued under such conditions afford neither measure of nor guide to the value of the property."

In this the court does not repudiate the idea that under some circumstances the amount of the bonds and stock are to be taken into consideration in fixing the value of the property, but holds that under the circumstances detailed they can have no weight, and thus followed exactly the same idea as in Smyth v. Ames, that such matters are to be considered in the final determination of the case and given such weight as may be just.

There is not a word in this case which shows that the court entertained any different idea of value than theretofore. The case below was tried upon the theory that value could best be shown by the cost of reproduction. The court declares that this is one way of establishing value, but if adopted the amount of depreciation must be ascertained. It practically admits that the amount of the capitalization of the company is a proper element for consideration, but only in cases where the capitalization is honest and fair, and that the capitalization of the company in the case before it was made under such circumstances that it could be called neither honest nor fair. Cost of reproduction new was one of the matters stated by the court as proper to take into consideration in Smyth v. Ames. That it is a proper way to ascertain the present value of large classes of property no one disputes or ever did dispute. It is certainly inconsistent with the debtor and creditor view urged by Professor Commons, for the reason that the cost of reproduction may be an entirely different thing from the amount of investment, even if such investment be perfectly fair and proper at the time it was made. Cost of reproduction necessarily recognizes both appreciation and depreciation in value. It does not take into consideration the manner in which the title to the property was obtained by the

company; it does not consider the fact that the property was given to the company as a circumstance which should deprive it of returns upon it.

Willcox v. Consolidated Gas Company, 212 U. S. 19.

This case was decided January 4th, 1909, four of the judges sitting in Smyth v. Ames being members of the court, namely Peckham, Harlan, Brewer and White, and concurring in the opinion by Justice Peckham. The case is this:

The legislature of the State of New York had fixed the rate to be charged by the Consolidated Gas Company, in the City of New York, at eighty cents per thousand cubic feet. The Gas Company filed its bill in equity in the United States Circuit Court, to enjoin the enforcement of this act upon the ground that the rate was so unreasonably low as to constitute practically a confiscation of its property. The Circuit Court entered a final decree restraining the defendants from enforcing the provisions of the act; from this decree appeals were taken by the Public Service Commission, First District, by the City of New York and by the Attorney General of the State. The Supreme Court reversed the decree with directions to dismiss the bill without prejudice.

The reasons for the reversal were briefly: (1) The court held that under the circumstances of the case the company was entitled to have its franchises valued. It further held that the court below in reaching its conclusion that the rate was confiscatory had valued these franchises at too high a sum and upon, in part, a purely speculative basis.

(2) That the value of much of the other property depended largely upon the opinions of expert witnesses. A large part of it consisted of real estate, the value of which was only ascertained by the varying opinions of expert witnesses, and where the opinions of the plaintiff's witnesses differed from those of the defendant's it was apparent that the total value must be more or less in doubt. It in other words became a matter of speculation or conjecture to a great extent.

(3) That in a close case, such as the one before the court, where the value of much of the property was doubtful, rates

should not be held unconstitutional without a trial sufficient to determine the actual working of the challenged rate.

(4) That it was not a case for valuation of good will; that the company had a monopoly in fact, and the consumer in the company's territory must either take gas or go without. An allowance was made by the court below in the value of the property for good will.

There is nothing in the case which tends in the slightest degree to show any shifting of the court as to the meaning of value; on the other hand a study of the report shows there had been no such shifting.

(1) The court distinctly recognizes that appreciation in value must be considered. Thus, on page 52, it says:

> "And we concur with the court below in holding that the value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property, which legally enters into the consideration of the question of rates, *has increased in value since it was acquired,* the company is entitled to the benefit of such increase. This is, at any rate, the general rule."

This is a distinct negation upon the notion that the amount of the cash investment is the value of the property for rate making purposes.

(2) Counsel for the Public Service Commission argued in his brief (p. 26) that "the basis of value of the land occupied by the complainant's plants should not exceed its cost to the company." He further contended as follows (p. 26): "But if the basis of valuation is to exceed the cost of the land it should still not exceed the estimated cost of replacing it with other land capable of accomplishing the same result."

These contentions are directly in line with the alleged shifting of the Supreme Court on the question of what constitutes value. If such alleged shifting had really taken place, as claimed, it would seem that counsel's contention would have met with approval, whereas it met with disapproval, as shown by the preceding quotation from the opinion.

(3) Some stress appears to be laid by Professor Commons upon the use of the word "reasonable" and the word "fair" in connection with value. At page 41 the court lays down

the rule: "There must be a fair return upon the reasonable value of the property at the time it is being used for the public." For this it cites the two San Diego cases. The court does not appear to attach much, if any, importance to the use of the adjectives "fair" or "reasonable." In upwards of a dozen instances in discussing the various aspects of the case it uses the word value without any limitation as to "fair" or "reasonable," and in one case it speaks of a "fair estimate of the value of the property" in such connection as to leave no doubt that it had in mind that the value of all property is in the nature of an estimate, and when the expression "fair value" is used what is really intended is a fair estimate or a reasonable estimate of that value.

The case may be searched in vain for any evidence that the mind of the court is in a transition state on value or that it has shifted its position from that taken in Smyth v. Ames. It recognizes appreciation in land value and also that value of land may be ascertained by the opinion of witnesses which can be true only of exchange value.

Minnesota Rate Cases, 230 U. S. 352.

These cases were decided June 9th, 1913, the only member of the court sitting therein who was in Smyth v. Ames being Chief Justice White; the opinion was by Mr. Justice Hughes. Certain rates were established for intrastate railroad business in the State of Minnesota by an order of the Railroad and Warehouse Commission. These rates were assailed by stockholders of the several railroad companies affected upon two grounds:

First: That they imposed a direct burden upon interstate commerce and created a discrimination as against certain localities in other states.

Second: That they were confiscatory.

Two of the cases were reversed and remanded with directions to dismiss the bills without prejudice; in one case the judgment below was modified, and as modified was affirmed.

So far as the case relates to the questions under consideration the court held:

(1) That private property embarked in the public service is not placed at the mercy of the state caprice; that it rests secure under the constitutional protection which extends not merely to the title but to the right to receive just compensation for the service given to the public.

(2) That the basis of calculation in ascertaining whether the compensation permitted is just is the fair value of the property used for the convenience of the public as stated in Smyth v. Ames or as the court said, quoting the language in the National City case: "What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public."

(3) "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."

It was pressed upon the court by counsel for the state (see page 359): (a) "Where a right of way has been donated free of cost it should not be included in the aggregate amount upon which to base a return;" (b) that the "lands secured under the right of eminent domain should never be valued at more than original cost;" (c) apparently, that construction procured or purchased by the use of earnings should not be included in the value of the property.

The court declined to accede to these contentions, saying at page 454:

> "It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership, and it is that property and not the original cost of it of which the owner may not be deprived without due process of law."

This is a distinct recognition that in rate making cases there may be an appreciation in the value of the property subsequent to its acquirement, and that such value may be greater than the amount of the investment in the property. Such an appreciation is only possible upon the view that the value of property is exchange value. In other words, that the word value has precisely the meaning that it has in condemnation and taxation cases and in common usage.

The court recognizes at page 452 that, "The cost of reproduction method is of service in ascertaining the present value of the plant when it is reasonably applied and when the cost of reproducing the property can be ascertained with a proper degree of certainty." This statement is entirely inconsistent with the idea that cost of reproduction is necessarily the value of the plant, while it does distinctly recognize that it is a means or method of ascertaining such value when it is reasonably applied. The recognition of cost of reproduction as a means of ascertaining present value is, of course, a complete negation of the notion that fair value or reasonable value consists in or is equal to the amount of the investment made in the property.

It disapproves of the application of the cost of reproduction theory to the valuation of railroad lands. This disapproval is couched in very vigorous language, which need not be quoted since it does not intimate that the value is merely the amount invested in the land, and as above shown the court distinctly states: "It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment."

The use of cost of reproduction new as a basis of ascertaining the value of items of construction, such as roadbed, structures, etc., was referred to (p. 456) but without any disapproval, while elsewhere it is mentioned approvingly when reasonably applied.

It must be said in all fairness that while the reasoning of this case completely disposes of the contention that the court has been shifting its position upon the question of what constitutes value, and that it has finally reached a state of

mind which would compel it to hold that fair or reasonable value meant the cash investment made in the property, it was decided some months after the statement of Professor Commons before the Senate Committee, and hence he did not have its benefit in checking up the correctness of the views which he there expressed. It is but reasonable to suppose that in the light of this opinion he would feel compelled to revise very materially some of the statements there made by him.

San Joaquin Co. v. Stanislaus County, 233 U. S. 454.

This case was decided April 27th, 1914.

It was a bill to restrain the enforcement of orders passed by the Boards of Supervisors of the three defendant counties, establishing water rates to be charged by the plaintiff, the San Joaquin Co.; the ground of the bill being that the orders deprived the plaintiff of its property without due process of law. The question before the Supreme Court was very narrow, and is stated by it in the following language:

> "If the plaintiff is entitled to six per cent. upon its tangible property alone it is agreed that the orders must stand. But if the plaintiff has water rights that are to be taken into account, the rates fixed will fall short of giving it what it is entitled to and must be set aside. The Circuit Court dismissed the bill, and on this appeal figures are immaterial, the only question being whether the principle adopted is right."

Among other contentions, the defendant counties urged as follows:

> "The water rights cost complainant nothing.
> "Complainant was not entitled to have its alleged water rights valued, because it diverted the waters from a public stream for public use, without cost to it for such waters."

In reply to this contention, the court said:

> "It is not disputed that the plaintiff has a right as against riparian proprietors to withdraw the water that it distributes through its canals. *Whether the right was paid for, as the plaintiff says, or not, it has been confirmed by prescription and is now beyond attack.*"

There are other contentions in the case not material at this time, which were also disposed of adversely to the defendants, and the decree was reversed.

The foregoing is a direct adjudication that whether the property in a rate making case cost the plaintiff anything or not is wholly immaterial, provided he owns it; that the plaintiff owned certain water rights and was entitled to have them valued in the case whether or not it paid anything for them.

END OF
TITLE